

SOME THOUGHTS ON INFLATION TARGETING

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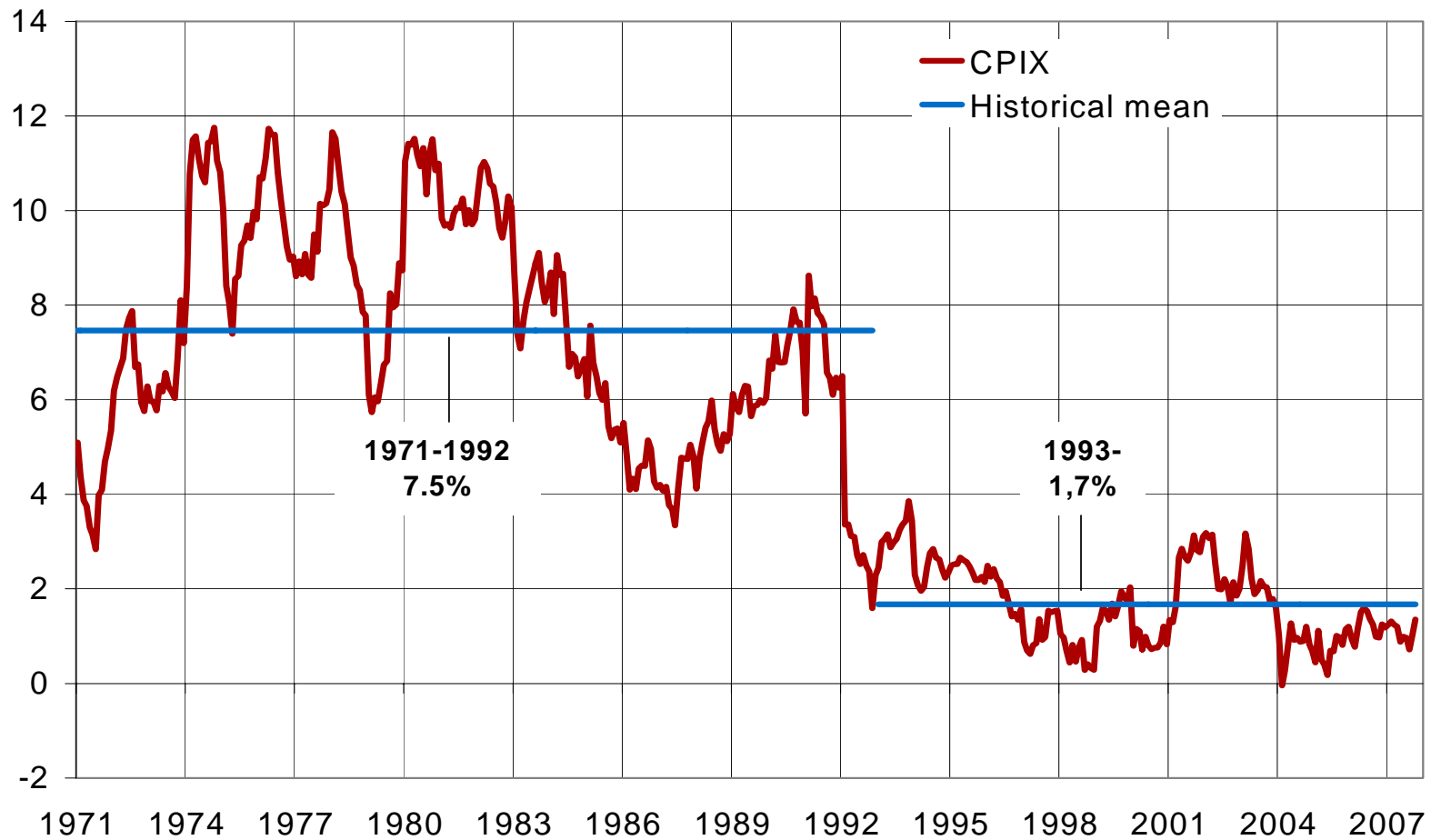
The record

- Introduced 1993. Accepted by Parliament some years later.
- Impressive results. Inflation and expectations in line after a few initial years. Less volatility in inflation and output. Good growth.
- Resemble other IT-countries. Some 70 countries today. No country has changed regime (except for EMU).

..... But a favourable world.

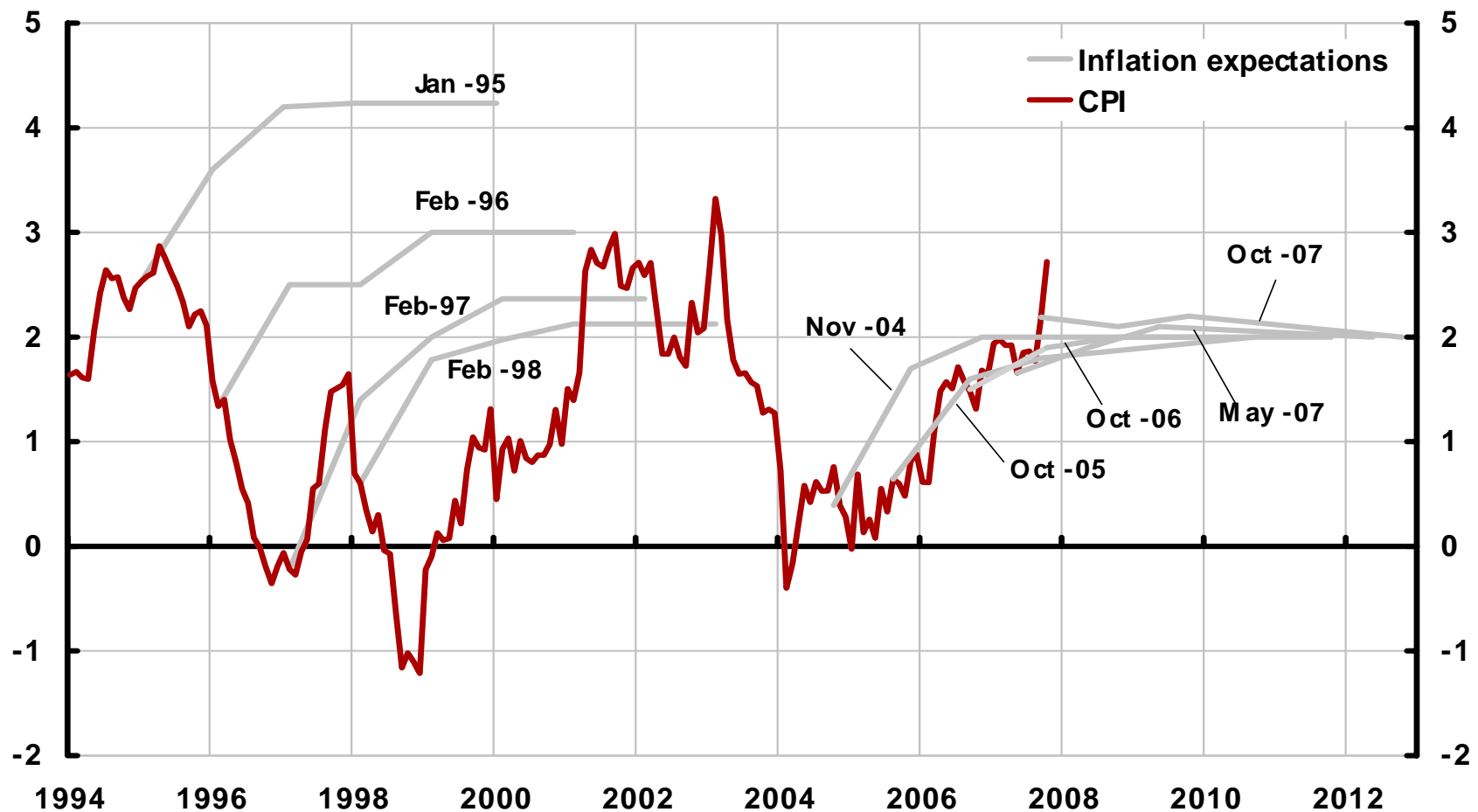
CPIX inflation and historical mean

Annual percentage change



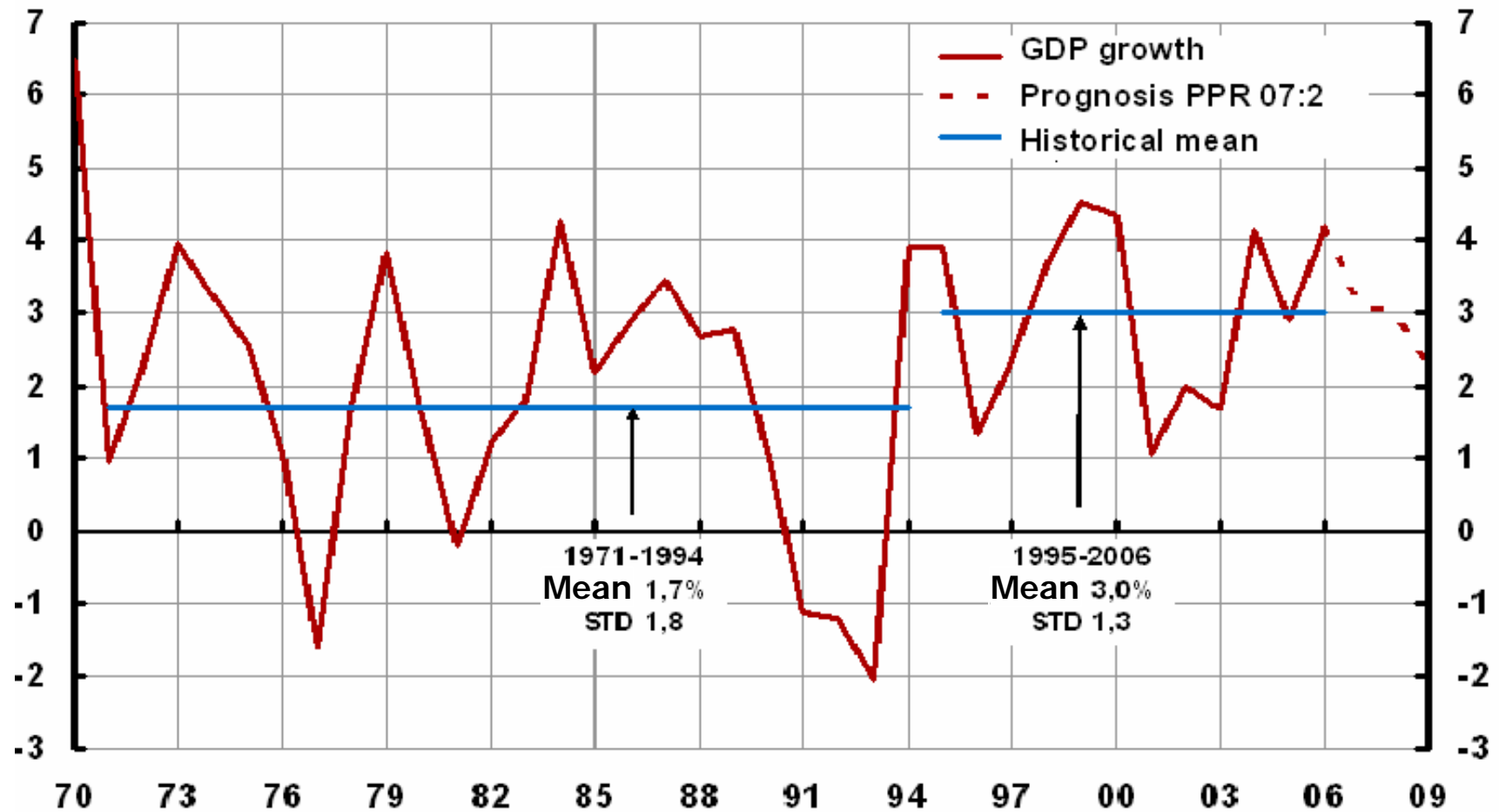
Inflation expectations by money market agents

Per cent



Growth

Annual percentage change and historical average



The main building blocs

- A way to deal with time inconsistency.
- Inflation forecast targeting/synthesis of rules and discretion.
- Sensible degree of concern for stabilization can be combined with focus on the value of money in the long run. Key word: explaining.
- Essential building blocs: numerical target, forecasts and explanations of behaviour.

How to deal with asset prices?

- Topical issue, but not new. Fundamentally difficult.
- IT never only about inflation. Real effects also taken into account. Financial stability is often also a target for Central Banks.
- Riksbank clear: We have been prepared to act. In that sense different from Greenspan. However, our thinking in line with Greenspan's "risk management approach".

How to deal with asset prices? (cont'd)

- In practical terms; follow all risks in the financial sector. Try to judge if they will affect real or financial stability. Lean against the wind.
- But limited scope for monetary action. Substantially higher rates would have substantial effects. Could that have been motivated?
- More focus on other policies. Taxes, regulatory policies etc.

Communication

- IT-works – in many ways – because of transparency.
- Some aspects:
 - Avoid mixing IT with exchange rate targets.
 - Develop forecasts, but focus on what is the essential: a good forecast combined with explanations of the policy chosen.
 - Strive for political support – explicit endorsement of targets limits the room for “snipers”.

Decision making structures

- Observers should be able to read policy. Policy „boring“.
- Raises difficult issues in particular for banks with boards.
- Blinders' conclusion: One size does not fit all. Genuinely collective or individualistic committees preferred from point of view of decision. Communication problems manageable.
- Need for legitimacy should be added. Underlines advantages with individualistic approach.

Central Bank Transparency Matrix

	<i>Individual decisionmaker</i>	<i>Autocratically-collegial committee</i>	<i>Genuinely-collegial committee</i>	<i>Individualistic committee</i>
<i>immediate statement</i>	most detailed	detailed	may need to be terse	may need to be very terse
<i>minutes</i>		least detailed	detailed	most detailed
<i>vote</i>		desirable, but may not be very informative		critical, with names
<i>inputs</i>	approximately the same for all; all should say more			
<i>Future r's</i>	Can project r_{t+j}	Can it project r_{t+j} ?	Bias only	Can it agree on bias

Source : Blinder, A., Monetary Policy by Committee : Why and How ?, DNB working paper

Be aware of over-stretch

- 10-15 good, years but head winds have increased.
- IT will help also in this world: Central Banks in much better position than during the 70'.
- But there are risks:
 - Need to combine well function IT with policies dealing with financial problems. Separate as much as possible. Take care in explaining.
 - Watch out for over-stretch. Optimal control might give the wrong impression. Need for realistic ambitions!